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IN THE

Supreme Court of the United States

OCTOBER TERM, 1955

No. 51

FEDERAL POWER COMMISSION,
Petitioner,

v.

SIERRA PACIFIC POWER COMPANY,
Respondent.

No. 53

PACIFIC GAS AND ELECTRIC COMPANY,
Petitioner,

v.

SIERRA PACIFIC POWER COMPANY,

ON WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

BRIEF FOR RESPONDENT SIERRA PACIFIC POWER COMPANY

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ON WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

BRIEF FOR RESPONDENT SIERRA PACIFIC POWER COMPANY

Questions Presented

1. Whether a contract to sell electricity at wholesale at a special low rate for a fixed period of years which has been accepted for filing as the legal rate by the Fed-

eral Power Commission is binding upon the parties until and unless abrogated by the Federal Power Commission after a hearing and finding that it has become unreasonable and against the public interest, or whether such a contract may be abrogated at any time by the selling company itself by the mere filing of a schedule of higher rates.

2. Whether, if Congress delegated its power to abrogate duly filed private rate contracts exclusively to the Federal Power Commission, that Commission can accept for filing and permit to become effective a proposed schedule filed by a utility company under Section 205(d) of the Act which increases the contract rate without the consent of the purchaser, in the absence of any hearing or finding that the contract rate is unreasonable and against the public interest.

3. Whether the statement by the Commission in its order approving an increase filed under Section 205(e) that if necessary it would find the contract too low and therefore unreasonable constitutes the finding of unreasonableness required by the Act, and whether, even if it were so construed, such a finding would retroactively abrogate the contract and validate the rate increase previously filed and permitted to become effective in 1953 under Section 205.

4. Whether, regardless of the legality of the contract, it was an abuse of administrative discretion for the Commission on the record of this case to permit Pacific Gas and Electric Company to increase the contract rate unilaterally in the absence of any showing that the public interest is injuriously affected thereby.

Statement of the Case

Because of the persistence with which both petitioners, as well as the Federal Power Commission[1] itself in its opinion and order here under review, attempt to gloss over the shocking impropriety of Pacific Gas & Electric Company's[2] attempt to repudiate its solemn agreement, and to belittle and even deny the unassailable equities in favor of Sierra Pacific Power Company[3], we deem it necessary to outline the facts disclosed by the record in some detail, so that the Court will have a complete picture of what has actually taken place.

The Parties

Sierra is a public utility under the laws of the States of Nevada and California. It generates, transmits and distributes electricity, water and gas to its customers, the consumers of northwestern and central Nevada and eastern California. Its service area embraces such centers as Reno and Carson City, Nevada and Lake Tahoe in California, and the surrounding regions (R. 5, 467).

PG&E is a California corporation and a public utility under the laws of that State and under the provisions of Part II of the Federal Power Act (Act of August 26, 1935, c. 687, 49 Stat. 847, U.S.C.A., Title 16, §824(e)). It is the company which serves most of north-central California from the San Francisco Bay area and the Pacific Ocean eastward to the Sierra Nevada Mountains, and from Bakersfield and Santa Ynez in the south to Eureka and Redding in the north.

1. Hereinafter referred to as "the Commission".
2. Hereinafter referred to as "PG&E".
3. Hereinafter referred to as "Sierra".

Past Dealings Between the Parties

Since 1923 Sierra has purchased a portion of the electricity needed to serve its customers from PG&E and is today dependent upon PG&E for the great bulk of that energy.[4] The purchases have been carried out under long-term contracts between the companies. The first was entered into in 1923 (R. 6, 443, 468), and was succeeded in 1938 by a 15-year contract to run to 1953 (R. 443, 468). Each contract fixed a rate during its term, and under each PG&E agreed to build a transmission line from its power plants in the Sierra Nevada Mountains at Drum and Spaulding, California, to a metering station near the Summit Hotel in the Donner Pass in California (R. 443). At this point delivery was made to Sierra, which transported the power over its own lines from that point to its own service area (R. 138, 443). The contracts provided for a substantial penalty if Sierra obtained any power from a source other than its own existing plants located in the State of Nevada.

Each contract was approved by the Public Service Commission of California (then known as the Railroad Commission) and was filed with the Federal Power Commission as PG&E's Rate Schedules FPC Nos. 1 and 2, respectively (R. 468).

Negotiations Leading Up to the Present Contract

With the end of World War II it became apparent that Sierra's rapidly increasing demands would require either the construction of an additional transmission line into its area by PG&E, or the development of a new source of power before the expiration of the 1938 contract in 1953 (R. 5-6, 21-23).

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4. In 1952 Sierra purchased approximately 77% of the kilowatt hours which it needed from PG&E (R. 467).

At the same time vigorous agitation for lower electric rates had developed among Sierra's consumers in Nevada and their public officials (R. 12-13, 16-17, 28-29, 336-341). One of the causes of this agitation was that the State of Nevada had never made use of the share of so-called "cheap government power" (R. 12-13) from Boulder Dam to which it was entitled under the Act of Congress setting up the Boulder Dam Power Project. (Act of December 21, 1928, c. 42, 45 Stat. 1057, U.S.C.A., Title 43, §617 *et seq.*) (R. 171-173, 336-337.)

Sierra called its problems to the attention of PG&E. According to a report made by the manager of PG&E's own Commercial Department after a field investigation in Nevada, Sierra was at that time considering five possible sources of power, other than PG&E, in its search for lower rates, including various plans for obtaining power from the United States Bureau of Reclamation, building its own steam plants in Nevada, and other possibilities (R. 166-176). After calling attention to the widespread agitation for lower rates in Nevada, the report recommended that PG&E study the possibility of supplying Sierra at more favorable rates (R. 175-176).

On January 22, 1947, PG&E offered to construct the necessary third transmission line in consideration of a new 15-year contract at substantially the same rates as those provided for in the 1938 contract, but with the addition of an escalator fuel clause under which the rate would increase as PG&E's fuel costs increased (R. 11-13, 179-183). Sierra refused to accept this proposal and thereupon, with the full knowledge of PG&E (R. 336-341, 415-416), it turned to intensive negotiations with the Bureau of Reclamation and other agencies in an effort to comply with the public demand for "cheap government power" (R. 336-341).

On August 15, while these negotiations were in progress, the Bureau wrote to PG&E to inquire whether it would

be prepared to "wheel" Government power from Shasta into Nevada over its existing lines, the power to be sold to local distributing companies (i.e. Sierra) (R. 415-416).

On October 4, 1947, Sierra finally rejected PG&E's proposal of January 22nd (R. 10-12, 339-341), and on October 6, PG&E's management for the first time determined to study the possibilities of offering Sierra a special low rate, known as "P-31", and to compare the results of service under that rate with the proposals of the Bureau of Reclamation to furnish power from Shasta Dam in its Central Valley Project in Northern California (R. 339-341, 416-424).

By that time the various proposals for obtaining power through the Bureau had been reduced to two: (1) the above mentioned proposal that PG&E should enter into an "exchange" or "wheeling" agreement whereby it would transport Bureau power from Shasta Dam to Summit for the Bureau's account, where it would be sold by the Bureau for Sierra's use (R. 415-416, 424, 331-334); and (2) a proposal that the Bureau would build one or more new lines to transport Shasta power directly over the Sierra Nevada Mountains into Nevada, where it would be sold to Sierra at the Bureau's publicly advertised resale or "postage stamp" rate (R. 305-307, 23-28).

The studies made by PG&E's management showed that PG&E could meet the Bureau's exchange or "wheeling" proposal by purchasing power from the Bureau at Shasta Dam for its own account under its existing contract with the Bureau and selling it to Sierra at the P-31 rate (R. 416-424). The studies also indicate that while the Bureau's proposal to sell power directly to Nevada at its "postage stamp" rate over a new line to be constructed over the mountains would produce a substantial saving to Sierra, the cost to the Bureau of constructing

the line would seem to be prohibitive, although the studies indicate that "Sierra Pacific believes it will be" done (R. 424). These studies will be discussed more fully in Point V, *infra*.

Following these studies, PG&E on October 25, 1947, finally acceded to Sierra's insistent demand for a lower rate, and offered Sierra a 15-year contract at the P-31 rate. Moreover, the escalator fuel clause to which Sierra had objected was eliminated, thus removing any possibility that the rate could be increased during the life of the contract because of possible increases in PG&E's future fuel costs (R. 11-13, 28-29, 138-146).

PG&E's P-31 rate is a special rate (R. 299), considerably lower than the rate then in force under the 1938 contract between PG&E and Sierra, which had been promulgated by PG&E in 1945 for the express purpose of enabling PG&E to meet competition and hold existing business (R. 148-149). It was to apply only to sales of power by PG&E to resale customers who signed contracts for not less than five years, and was not expected to return the full allocated cost of service, although designed to exceed the loss which PG&E would suffer if it lost existing business (R. 151-164). One of its avowed purposes was to assure the customer that it would receive the agreed low rate at least for the duration of the contract (R. 162-163).

This schedule had been approved by the California Public Service Commission (then the Railroad Commission) on October 16, 1945, on the express condition that any loss from such service must be borne by the stockholders of the utility and could not be passed on to PG&E's other customers (R. 149).

Before accepting PG&E's offer Sierra's rate engineer prepared studies comparing the cost to Sierra under the P-31 rate with the cost under the Bureau's proposal

to build a new line from Shasta and sell directly to Sierra at its "postage stamp" rate. While these studies showed that the rates under the Bureau's proposal would be considerably more favorable to Sierra over a 15-year period even than the P-31 rate offered by PG&E, nevertheless the studies also showed that the Bureau would be unable to construct the new line in sufficient time to meet Sierra's anticipated peak demands in the ensuing years (R. 14-16, 29-34). Accordingly, Sierra's management finally determined in late December, 1947 to accept PG&E's proposals (R. 16). After some months of negotiation over the details the contract was finally entered into on March 4, 1948, subject to approval by the California Commission (R. 138-146).[5]

After hearings at which the Commission obtained PG&E's commitment that the burden of the low rate would be absorbed by it, and not passed on to PG&E's other customers (R. 202) the California Commission approved the contract on April 27, 1948 (R. 260-266). Thereafter it was duly filed with the Federal Power Commission as PG&E's Rate Schedule FPC No. 3. (R. 468).

While the Threat of Competition Remains PG&E Asserts it Would be "Double Dealing Repudiation" to Seek to Increase the Rate

In the year following the adoption of this agreement, PG&E filed a petition with the California Commission seeking a general 6% rate increase, but expressly requested permission to exempt some 21 of its customers who had contracts under the P-31 rate, including Sierra,

5. In 1948 Sierra was PG&E's sole interstate purchaser, so that any injury resulting from the low rate provided for in the contract would fall upon its intrastate customers over whom the California Commission had sole jurisdiction.

from this increase on the ground that the contracts had been negotiated under competitive conditions (R. 268-271). As PG&E's counsel stated at the hearing in support of the proposed exemptions, "anybody would agree that we would be accused of double dealing repudiation" if PG&E sought to increase these contract rates (R. 278).

In authorizing the 6% increase as well as the exemption of the P-31 customers, the California Commission in an order dated March 21, 1950, stated that the exemptions were justified on the ground "* * * that the making of such special contracts was compelled largely by competitive conditions * * *" (R. 292-293) and that, "In approving such special contract rates in the past, we indicated that, if the revenue therefrom should fall below the cost of service, the loss would not be permitted to burden the other classes of customers" (R. 293).

As Soon as the Threat of Competition is Removed PG&E Tries to Repudiate its Low Rate Contracts

By 1952 PG&E had entered into a new comprehensive contract with the Bureau to transport or "wheel" power generated at Shasta Dam to the Bureau's customers within a defined area (which does not include the area served by Sierra) and to purchase the balance of the power generated at Shasta for its own use (R. 17-18).[6] By that time, also, the cost of construction of steam plants had become almost prohibitive for a company situated as Sierra is. Thus the major sources of competitive power in the area were no longer available to Sierra (R. 17-20, 58-61).

6. In its brief in the Court below PG&E asserted that this statement was "false". We thereupon communicated directly with Mr. Calland, Acting Regional Engineer of the Bureau, who had conducted negotiations with Sierra in 1947, and were informed by him that all of the Bureau's available power was presently tied up partly by the general wheeling agreement above referred to and partly by another agreement whereby PG&E wheels 200,000 Kw's to the Sacramento Municipal Utility District for the Bureau's account.

Accordingly, when in 1952 PG&E again applied to the California Commission for a general increase of approximately 18%, it no longer sought to exempt Sierra and the other P-31 contract customers, with the exception of the City of Redding, which PG&E sought to exclude from the increase on the express ground that, because it was located within a few miles of the Shasta Dam, the danger of Bureau competition still existed (R. 280-282).

The California Commission Refuses to Permit PG&E to Repudiate its Contracts

While authorizing the general rate increase which PG&E had sought, the California Commission refused to permit PG&E's attempted repudiation of its contracts (R. 282-291) and expressly stated that it would so compute PG&E's general rate schedule as to insure that "* * * no burden [from the low contract rates] will be placed on the other classes of customers but any burden will fall on the stockholders' portion of the earnings until such time as the contracts may have been renegotiated and have been authorized by the Commission" (R. 285). After pointing out that the 15-year period in Sierra's contract was established "* * * to provide protection to both parties" (R. 283), the Commission concluded its order as follows:

> "In connection with these special contracts, we point out that the applicant, in order to forestall alleged government competition, requested authority from this Commission to enter into said contracts with the clear understanding that its stockholders must bear any burden which the applicant might sustain as a result of the operation of any such contracts. Therefore, equity calls for the treatment which we have accorded to these special contracts" (R. 285-286).

Having failed to obtain the sanction of the California Commission in its attempted "double dealing repudiation" (R. 278), PG&E initiated the present proceeding in the Federal Power Commission.

The Proceedings Before the Federal Power Commission

PG&E's proposal to increase the contract rate was filed on February 2, 1953 under the provisions of Section 205 of the Federal Power Act, which will be discussed more fully hereafter (Act of August 26, 1935, c. 687, Title II, 49 Stat. 851, U.S.C.A., Title 16, §824d). Thereafter the Commission invited comments from the California Public Utilities Commission, the Nevada Public Service Commission, and Sierra. The California Commission refused to comment on the ground that a similar application by PG&E was then pending before it (R. 445). The Nevada Commission, which has jurisdiction over Sierra's resales to Nevada consumers, opposed the increase in a letter which said in part, "Had there been any doubt of the validity of the contract between the two companies, this Commission would have ordered Sierra Pacific Power Company to construct" additional facilities of its own to meet the increasing demand for power (R. 436). Sierra filed a petition and later an amended petition, objecting to the increase and requesting that the Commission reject the filing.

The burden of Sierra's petitions requesting that the Commission reject PG&E's filing was that it was improperly made under Section 205 of the Federal Power Act, under which Sierra contended that a contract rate could not be increased without its consent, pointing out that PG&E's proper procedure, if it had any ground for being relieved of its contract, was to bring a petition under Sec-

tion 206 of the Federal Power Act (*supra*, at 49 Stat. 852, U.S.C.A., Title 16, §824e), which expressly authorizes the abrogation of a contract by the Commission after a hearing and finding that it is unreasonable and against the public interest (R. 445).

In its order of April 17, 1953 granting Sierra leave to intervene but denying the other relief requested by Sierra in its petitions the Commission provided in part as follows:

> "Sierra's petitions in all other respects be and the same hereby are denied, without prejudice to the right of Sierra to maintain its contentions as to the effect of the filing of Supplement No. 1 under Section 205 (d) of the Act, and as to the Commission's authority in this proceeding" (Order of the FPC *In the Matter of Pacific Gas and Electric Company*, Docket No. E-6482).

Sierra's petition for rehearing was dismissed on the ground that this was not a final order (R. 446). Accordingly, Sierra proceeded with the hearings and attempted to persuade the Commission that as a matter of law the contract rate could not be increased unless it was found to be unreasonable, and that, as a matter of fact, it did not injuriously affect the public interest, and therefore should be sustained. Sierra also sought to persuade the Commission that, regardless of the legal question involved, as a matter of equity it should follow the California Commission and refuse to sanction PG&E's blatant and unjustifiable attempt to repudiate a solemn obligation.

After hearings before a Presiding Examiner of the Commission, the intermediate decision procedure was dispensed with and briefs and oral argument were presented to the Commission on July 22, 1953 (R. 446). On September 21, 1953 the Commission ordered counsel to reargue certain

questions which it specified, relating to the rate of return which had been foreseen, or had been reasonably foreseeable, by PG&E at the time it entered into the contract (R. 438-439). Although neither Sierra nor PG&E agreed that the questions proposed by the Commission were relevant to the issues in this proceeding, both sought to comply with the Commission's order (R. 446-447). Further hearings were held before the Presiding Examiner at which, despite the existence of the studies embodied in Exhibits 44 and 45 (R. 416-424), hereinabove referred to, which contained detailed studies of the cost of rendering the service, but of which Sierra was, at that time unaware, PG&E asserted that before entering into the 1948 contract it had not made a cost of service study, nor any attempt to foresee the actual rate of return which it expected to receive under the contract over the 15-year period (R. 113-115, 107-108, 424). Accordingly, PG&E offered Exhibits Nos. 35 (Revised), 36 (Revised), 39, 40, 41 and 42 (R. 356-414), as an attempted reconstruction of the rate of return PG&E's management might have anticipated if they had made such a study in 1947 prior to entering into the contract. These Exhibits were prepared in part on the basis of certain facts which were available to PG&E's management at that time (R. 392).

At the close of this rehearing, Exhibits 44 and 45 hereinabove referred to were for the first time produced, during the cross-examination of PG&E's witness. Sierra offered these exhibits in evidence, as the only available evidence of the rate of return which PG&E had in fact anticipated from the proposed contract, and objected to the admission of PG&E's Exhibits Nos. 35 (Revised), 36 (Revised), 39, 40, 41 and 42 on the ground that they were not admissible as evidence, as they were purely hypothetical and concededly had not been considered by PG&E at

the time it offered the P-31 rate (R. 133, 416, 424). This objection was overruled by the Presiding Examiner, although he expressed surprise that Exhibits 44 and 45 had not been produced by the Commission's Staff, in whose possession they had been for several months (R. 130).

On April 23, 1954 the reargument was had before the Commission, and on June 17, 1954 the Commission issued its Order and Opinion No. 270 (Commissioners Doty and Smith dissenting) which is the subject matter of this appeal (R. 443-470, 471-477).

The Commission's Order and Opinion

The majority of the Commission rejected Sierra's contention that the Federal Power Act did not authorize the unilateral abrogation of a duly filed rate contract by the mere filing of a new schedule under Section 205, and held that, on the contrary, that was the proper method of increasing a contract rate, provided the proposed increase was found to be not unreasonable by the Commission (R. 458-459). The majority further stated that, although it did not make any such finding, "* * * if a finding on the lawfulness of the 1948 contract rate were necessary or appropriate, on the record before us that finding would have to be that the 1948 rate is unreasonably low and therefore unlawful" (R. 464-465).

The majority further found that the proposed new rate is not unreasonable although it, like the contract rate, would produce a return substantially less than the 5½% which is stipulated as generally a reasonable rate of return on the electric utility business of PG&E (R. 21). The Commission based its decision on the ground that "the company is willing to accept" the low rate because it "regards the deficiency of .75 of a percentage point as

warranted in order to attract and retain this particular business in the face of the alternatives that may have been available to Sierra" (R. 464-465).

The majority also sought to justify its decision on the ground that "* * * the evidence also shows that such a rate of return [4.75] is not substantially different from the rate of return which it was willing to accept from this business at the time it negotiated the 1948 contract rate * * *" (R. 464-465). This conclusion is based upon the hypothetical rate study presented at the second hearing as Exhibit 35 (Revised) (R. 356-408), hereinabove referred to. The Commission also states that it finds "unconvincing" Sierra's contentions that it gave up opportunities to obtain power elsewhere in reliance upon this contract, and that it would be grossly unfair to increase the rate while leaving the other provisions in the contract unaltered.

Commissioners Doty and Smith, in their dissenting opinion, conclude that while the contract is "* * * subject to our regulatory modification for adequate cause shown in a proper proceeding, * * * it is our conclusion that the evidence shows the rate provided for [in the contract], when considered in relation to the other terms of the contract * * * and in the light of all the relevant attendant circumstances and conditions, to be lawful,—because not unjust, unreasonable, or unduly discriminatory—and therefore that it should be continued in effect" (R. 471). They also reject the majority's reliance upon the hypothetical anticipated rate of return to justify the proposed increase, asserting that the Commission should utilize the incremental cost test, which was the method actually used by PG&E in Exhibits 44 and 45, on the basis of which the P-31 rate was finally offered, in determining what rate of return was foreseen by PG&E when the contract was entered into (R. 472-474).

The Decision Below

On review the Court of Appeals for the District of Columbia Circuit reversed the Commission's Order on the ground that under the Power Act the contract is valid and binding between the parties and may only be set aside by the Commission itself after a hearing and finding under Section 206(a) that the contract is injurious to the public interest (R. 478-482). While in its original opinion the Court directed that the case be remanded either for dismissal of the pending proceeding or for further proceedings under Section 206(a), the Court later modified its order on motion of Sierra so as to direct the Commission to dismiss the pending proceeding, without prejudice to the initiation of a new proceeding under Section 206(a) (R. 495).

There Are No Substantial Differences Between the Instant Case and the *Mobile* Case

In substance, there is no material difference between the issues presented in this case and those being presented to this Court in *United Gas Pipe Line Company* v. *Mobile Gas Service Corporation and Federal Power Commission*, and *Federal Power Commission* v. *Mobile Gas Service Corporation*, Nos. 17 and 31, this Term, hereinafter referred to as the "*Mobile* case" or "Mobile". Although that proceeding arose under the Natural Gas Act, and the present under the Federal Power Act, the arguments there presented are equally applicable to the Federal Power Act, for it is conceded by all parties that the two Acts are in all essential respects substantially identical.

The only differences between the two Acts are: (1) that under Section 4(e) of the Gas Act the Commission is forbidden to suspend a proposed change of rate for the

sale of gas for resale for industrial use only, whereas there is no comparable provision in Section 206(a) of the Power Act; (2) that a natural gas company is expressly excluded from the list of parties authorized to bring a proceeding to review an existing rate under Section 5(a) of the Gas Act, whereas Section 206(a) of the Power Act merely provides that such a proceeding may be brought "on complaint," without specifying by whom such a complaint may be filed, and (3) that the Gas Act prohibits the Commission from ordering an increase in rates under Section 5(a) except in accordance with a proposed new rate filed by the company, whereas there is no such prohibition in Section 206(a) of the Power Act. We submit that none of these differences could support a determination that while the Gas Act may outlaw rate contracts, the Power Act does not, or vice-versa. Nor do petitioners make any such contention.

There is also a procedural difference: The Commission denied Mobile's petition asking that the filing be rejected and dismissed Mobile's proceeding, whereas in the present case, although the Commission denied Sierra's similar petition asking that PG&E's filing be rejected, it did so without prejudice to Sierra's right to present its conten-

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7. Petitioners argue that the existence of this provision may have unduly influenced the Court of Appeals for the Third Circuit in reversing the Commission in the *Mobile* case, because of the evident inequity of compelling Mobile to pay at rates in excess of the contract rate without any possibility of suspension, particularly where, as they contend, such payment cannot be refunded. As we have pointed out in the *Mobile* brief at pages 61 and 62, there is no substance to petitioners' contention that under the Gas Act, such overpayments cannot be refunded. Petitioners' concern for the equities ignores the fact that Sierra has been forced to pay over $800,000 in excess of the rate provided in its contract during the two years that have elapsed since the increase went into effect, even after a five months' suspension. Thus the procedure ordered by the Commission would seem equally inequitable in either case. But in any event, as petitioners concede, this circumstance was by no means determinative of the Third Circuit's decision in the *Mobile* case.

tions at the hearing which it ordered. However, after the hearing, the Commission in its Order again rejected Sierra's contention that its contract rate could not be changed without a finding of unreasonableness, and held that the proposed new rate, being not unreasonable, was lawful. Thus the issue as to the right of a company to increase a contract rate by the mere filing of a proposed increase is squarely presented in both cases.

PG&E also contends that the Commission in fact made a finding of unreasonableness in the order here under review. While we deny that such a finding was made, we think it is apparent from the record that even if it had been made it would not validate the Commission's order and that on the record it would have to be set aside because the record discloses that the contract rate itself is reasonable. (See Point III, *infra.*) There is also a dispute between the parties as to the effect to be given to the evidence in the record. We contend that it shows that the Commission acted arbitrarily and improperly in permitting the abrogation of the contract, quite apart from the legal question as to the contract's validity under the Act. (See Point V, *infra.*)

But regardless of the procedural and factual questions which are raised by this record, the basic legal question as to the validity of the contract is still determinative. If the contract is valid and binding until and unless found unreasonable by the Commission, the decision below must be affirmed. It is only if the Court should hold that contracts do not survive the passage of the Act that the question of whether or not the Commission's order must be reversed as an abuse of administrative discretion need be reached. As the question of the validity of the contract is fully argued in the brief submitted on behalf of *Mobile*, the Court is respectfully referred to the arguments there set forth, on that issue.

Summary of Argument

1. Rate contracts in the electric industry are subject to the paramount power of the Government to abrogate or modify them when the public interest so requires, just as are any other private contracts. This power may be exercised either directly by the Legislature as in the Interstate Commerce Act, or the Legislature may delegate the power to an administrative body to be exercised in accordance with prescribed standards. It is clear from the language of the Power Act, especially when compared with the language of the Interstate Commerce Act, that the former expressly recognizes contracts and delegates the power to abrogate them to the Federal Power Commission after a hearing and finding under Section 206(a) that the public interest so requires.

(a) The reason for this difference between the two Acts is that contracts are not necessary in the railroad industry, whereas contracts to sell electricity at special low rates for a term of years are necessary in the electric industry where substantial investments are frequently necessary, in order to enable a utility to meet competition and protect its investment. This is well illustrated by the record in this case. When the Power Act is read in the light of this factual background, it is apparent why the right to enter into such contracts is expressly preserved in the Act, subject to the right of the Commission to abrogate or modify them when the public interest so requires.

2. Since Congress delegated to the Federal Power Commission the power to abrogate or modify rate contracts after a hearing and finding under Section 206(a) that the public interest so requires, such contracts cannot be modified or abrogated in any other way without the consent of the parties. They cannot be changed, as petitioners con-

tend, by the filing by a utility of its proposed new rate under Section 205(d). That section merely prohibits any utility from making a change in an existing contract without notice to the public and to the Commission and is no more than a requirement that public notice be given before any change agreed to by the parties may become effective. Its purpose is to avoid secret rates, not to grant to an electric utility the extraordinary power to change its own contracts unilaterally.

Section 205(e) is intended only for the purpose of investigating the reasonableness of a proposed new rate. Since more than one rate can be reasonable for a given service, if a contract rate could be modified in a proceeding under 205(e), the contract could be modified solely upon a finding that the new rate was reasonable, even though the contract rate, which would not be in issue, might also be reasonable.

(a) Accordingly, the Court below correctly held that the Commission was in error in permitting the contract rate to be increased in a proceeding initiated by PG&E under Section 205, and was also correct in amending its decision to require that the pending 205 proceeding be dismissed before any further steps are taken under Section 206(a). If the Commission were permitted now to make a finding in the present proceeding that the contract rate is unreasonable, the result might be to abrogate the contract retroactively and validate the rate increase filed under Section 205. The right of the Commission to fix new rates after finding an existing rate unreasonable under Section 206(a) is prospective only. It cannot now, by finding the contract rate unreasonable under Section 206(a), validate a rate which was filed under Section 205 on February 2, 1953, and which has been in effect since September 26, 1953.

(b) PG&E's contention that there is no difference in substance between a proceeding under 205 and a proceeding under 206 is based on the erroneous assertion that the contract rate and the proposed new rate could not both be reasonable. PG&E bases this contention on the further erroneous assertion that the Commission does not sit to review rates, but solely to fix rates, and that therefore all rates are fixed by the Commission and that "if the Commission finds a rate to be reasonable, a materially different rate is necessarily unreasonable". This is a complete distortion of the provisions of the Act. It is the company and not the Commission which fixes rates in the first instance. The primary duty of the Commission is solely to review rates or changes in rates fixed or proposed by a company. It is only when those rates are found to be unreasonable that the Commission has any power to fix rates itself. Whether or not a rate is reasonable may depend upon whether it is proposed by the company or whether it is imposed upon a company by the Commission. A particular rate when proposed by a company might not be unreasonable, even though the identical rate if imposed upon the company by the Commission would be unreasonable. For example, in the present case the Commission approved a rate producing a return of only 4.75% on the express ground that PG&E was willing to accept that rate. If the Commission had attempted to impose the same rate on PG&E without its consent, it would have been set aside as confiscatory. Thus it is plain that more than one rate may be "reasonable". Any rate proposed by a company which is neither exorbitant, "unduly discriminatory or preferential", must be approved by the Commission on review, even though the same rate might be unreasonable if imposed by the Commission without the company's consent. It follows that if a contract rate could be changed in a Section 205 pro-

ceeding, it could be set aside if the new rate were reasonable, even though the contract rate itself were equally reasonable.

3. PG&E seeks to justify the Commission's order on the ground that the Commission stated that if a finding of unreasonableness were necessary it would find that the contract rate "is unreasonably low and therefore unlawful", and that no rate would be reasonable "that would produce a return of substantially less than the 4.75% resulting from the proposed rate, *which is the minimum PG&E is willing to accept*" (R. 464). (Emphasis supplied.)

(a) This was not the formal finding of unreasonableness required by the Act. As the court below and the dissenting Commissioners correctly point out, the Commission did not make any finding of unreasonableness.

(b) Even if the Commission's language could be construed as a finding of unreasonableness, it would not support the Commission's order, for that order by its terms validates retroactively the new rate which had become effective in September 1953, nearly nine months before the alleged "finding of unreasonableness". The right of the Commission to fix new rates after a finding that existing rates are unreasonable is prospective only.

(c) In any event, even if the Commission's language could be construed as a formal finding under Section 206(a), it would have to be set aside as erroneous both in law and in fact. (1) The mere fact that a contract is unprofitable and that a company's stockholders may be losing money under it is no ground for setting it aside. The power to abrogate private contracts may be exercised only when the public interest so requires. It is clear from the Commission's own order and from the statements made before the Commission by Commission Staff coun-

sel, as well as from the record itself, that the contract rate here in issue is just as reasonable as the proposed new rate which the Commission has approved: it is neither preferential nor discriminatory and imposes no additional burden on PG&E's other customers. Any loss of revenue is borne solely by PG&E's stockholders. Nor is it contended that the low rate is so burdensome as to interfere with PG&E's ability to fulfill its public utility obligations. (2) The Commission was correct in relying on PG&E's "willingness to accept" a rate producing less than a fully compensatory return on its investment as justification for holding such a rate to be reasonable. The Commission itself could not have imposed a less than compensatory rate on PG&E without its consent. But the Commission was in error as a matter of *fact* when it asserted that the proposed new rate was "the minimum PG&E is willing to accept". In 1948, in entering into the contract here in issue, PG&E solemnly expressed its willingness to accept the contract rate for the duration of the contract. Thus the contract rate is "the minimum PG&E is willing to accept" and as it is not injurious to the public interest it is just as reasonable as the rate approved by the Commission. Hence the Commission may not set it aside. Indeed, for the very reasons advanced by the Commission in support of its approval of the proposed new rate, if PG&E were now filing the 1948 contract, it would have to be accepted by the Commission.

4. The record in this case makes it quite clear that the existence of private rate contracts in no way frustrates or otherwise interferes with the proper regulation of rates for electric power by a duly authorized regulatory agency.

5. Quite apart from the legal questions here involved, it was an abuse of administrative discretion for the Commission to permit PG&E to increase its rates in violation

of its contract. It is clear from the record that the public interest was in no wise adversely affected by the contract rates. The sole purpose and effect of the increase is to benefit PG&E's stockholders at the expense of consumers in Nevada. Moreover, the arguments and "findings" advanced by the Commission in its order, in an effort to justify its approval of this increase, are so arbitrary, capricious, unreasonable and so flagrantly disregard the facts in the record as established by PG&E's own witnesses and documents obtained from PG&E's own files, that, regardless of the question of law involved, the order must be set aside.

ARGUMENT

I

Private rate contracts are recognized by the Federal Power Act and are valid and binding as between the parties until and unless set aside by the Federal Power Commission after a hearing and finding under Section 206(a) that they are unreasonable.

It is plain from the language of the Federal Power Act, particularly when contrasted with the language of the Interstate Commerce Act, which outlawed contracts, that it expressly recognizes the existence of private rate contracts. But this does not mean that they are beyond the regulatory powers of the Commission. In Section 206(a) of the Power Act, Congress expressly delegated to the Federal Power Commission the power and duty to abrogate private rate contracts whenever the Commission shall find after a hearing that such contracts are "unjust, unreasonable, unduly discriminatory or preferential."

As we point out in the *Mobile* brief, the reason for this distinction between the two acts is that while rate contracts are not necessary in the railroad industry, they are necessary in the gas industry. An examination of the record herein will show that binding contracts for the sale of electric power are equally necessary in the electric industry.

A

PG&E has repeatedly requested and obtained permission from the California Commission to enter into contracts at special reduced rates for a fixed term of years in order to meet competition.

The Court will recall that while very little legislative history under the Gas Act was found dealing with the question here at issue, petitioner United itself in that case had testified before the Commission that contracts for the sale of gas for resale for industrial use only were essential to a proper growth and development of the gas industry. While there is even less legislative history bearing on this issue under the Federal Power Act, the record in the present case shows that petitioner PG&E has repeatedly presented evidence before the Public Utilities Commission of the State of California, formerly known as the Railroad Commission, that contracts for the sale of electricity for resale at special low rates for a fixed term of years are essential in order to enable PG&E to meet competition both in its sales to large industrial consumers and in its sales for resale to local distributing companies.

At pages 151 to 165 of the transcript of record herein, there will be found excerpts from the testimony of Mr. B. B. Beckett, PG&E's Chief Rate Engineer, at a hearing

held in 1945 before the California Commission at which PG&E sought and obtained the State Commission's approval of its P-31 rate schedule, the same rate that was subsequently embodied in the contract here in issue (R. 154).

Mr. Beckett begins his testimony by pointing out that the proposed schedule is a revision downward of an earlier schedule known as P-30 which had been approved by the Commission in 1936. In describing that schedule, he said:

> "* * * P-30 would mean a reduction to large industrial customers then being served on P-5 [a higher rate], providing they would sign contracts agreeing to take service for periods of 5 years. The purpose was to meet competition of Diesel engines and other isolated electric generating plants and to promote additional business.
>
> "* * * I do know of my general knowledge and studies that it is better to hold any business at a somewhat reduced rate than not to hold it." (R. 152)

Mr. Beckett then goes into great detail to demonstrate the advantages to PG&E of being able to offer contracts at special low rates in order to meet competition and hold existing business, provided the "incremental revenue is more than the incremental cost" of rendering the service (R. 158); or, putting it another way, "if the result does not produce such a low revenue and low rate that it would not meet the costs which might be eliminated if the business were lost" (R. 154). He concedes that these rates will not return the "full allocated average cost of rendering the service * * * if by 'allocated costs' you mean what is generally meant by that term, that is, taking the system business as a whole and proceeding to allocate to different classes, as is usually done by the method which is usually used in rate making" (R. 155). He then shows in some

detail that the company would receive little salvage value on its investment if it lost existing business in which it had a substantial investment, and that it is to the advantage of the company to hold such business at some return, computed on an "incremental cost" basis rather than to lose the business (R. 158). He also makes it quite clear that these low rates should not be permitted unless the customer agrees to enter into a contract for a period of at least five years, and adds "It should preferably be longer than 5 years" (R. 154). His testimony and that of other witnesses called by PG&E at that hearing are summarized in the decision of the California Commission approving the schedule as follows:

> "At the hearing, witnesses for Pacific explained the circumstances which had given rise to the proposed rate reductions. It was pointed out that the United States Department of the Interior, Bureau of Reclamation, has publicly offered a schedule of rates for the sale of electric energy generated at its Shasta hydro-electric plant, * * *. Such resale rate offered by the Bureau was substantially lower than Pacific's presently effective resale rates for similar services [under the existing P-30 schedule]." (R. 147)

At page 148, the Commission continues:

> "Testimony given by witnesses for Pacific, as well as by the Commission's staff, indicates that Schedule P-31 will not return all the costs which properly should be included if a full compensatory rate were being established.
>
> * * * * *
>
> "It justifies the offer of reduced rates to resale customers primarily in order to safeguard existing business * * *.
>
> "It is clear that Pacific has the legal right to reduce its rates in order to meet in good faith the

> competitive rates being offered by the Bureau of Reclamation. This right has frequently been recognized by the Commission. Our precedents to such effect, as well as the judicial authorities, were cited in the case of Modesto Irrig. Dist. *v.* Pacific Gas & E. Co. * * * However, as the Commission has clearly stated in that decision, as well as in many others, the loss, if any, incurred by a utility offering a competitively reduced rate, must be borne by the utility itself and will not be permitted to burden its other customers." (R. 149)

That these special low rate contracts were intended to be binding for the duration of their terms is also apparent from Mr. Beckett's testimony under cross-examination by the California Commission's Staff Counsel, Mr. Wehe:

> "Q. * * * Then, from the customer's viewpoint it would probably follow that the sole reason that that customer would sign up for a 5-year contract would be because of the opportunity to receive the lower rate under P-31 or P-30, isn't that right? A. Well, I would imagine that that would be—might be his reason right now, but I would think that he also might desire stabilization, *assurance that he will have service at this lower rate for a period of at least 5 years.*" (Italics supplied.) (R. 162-163)

That PG&E itself, at least as recently as 1950, believed that these contracts should be binding in accordance with their terms, is apparent from the position which it took in that year in a proceeding before the California Commission when seeking an over-all rate increase of 6% on its existing rates. In that proceeding, PG&E expressly requested that some twenty purchasers for resale which had P-31 contracts, including the contract with Sierra here in issue, should be excluded from the proposed increase. At the hearing on this application, Mr. J. S. Moulton, Vice

President and Executive Engineer of PG&E, testified in support of the application. After describing the existing contracts entered into under P-31, Mr. Moulton said:

> "Because of the competitive conditions under which these contracts were negotiated, which reasons were recognized by the Commission in authorizing them, we believe that the contracts with all these cities and with the Plumas-Sierra Cooperative should be exempted from the requested increase" (R. 270).

Finally, in summing up PG&E's contentions in support of the exemption of these special contract customers, Mr. DuVal, counsel for PG&E at that proceeding said "I think anybody would agree that we would be accused of double dealing repudiation" if PG&E had sought to increase these contracts (R. 278). The Commission, after reviewing the testimony, approved the exemption with the following proviso:

> "In authorizing Pacific [PG&E] to exempt certain resale customers from rate increases, we recognize the right of a utility to meet competition. In approving such special contract rates in the past, we indicated that, if the revenue therefrom should fall below the cost of service, the loss would not be permitted to burden the other classes of customers." (R. 293)

And as we have seen (pp. 9, 10, *supra*), in 1952 the Commission refused to permit PG&E to repudiate these contracts.

Thus there can be no doubt that contracts are both customary and necessary in the electric industry, in order to enable a utility company to meet competition, such for example as the threat of the construction of individual

steam plants by its large industrial customers or local distributing companies, or an offer of cheaper power from U. S. Government installations such as that at Shasta Dam.

When the Act is read in the light of this factual background, we think it is apparent, for the reasons set forth in the *Mobile* brief, that rate contracts are not outlawed by the Act, but remain as valid and binding agreements until and unless set aside in accordance with the procedure prescribed in Section 206(a).

II

PG&E's attempt to increase the contract rate by filing a schedule under Section 205 over Sierra's objection, being unauthorized by the Act, must be rejected by the Commission before any proceedings can be taken under Section 206(a).

As we have indicated in the *Mobile* brief, since Congress has delegated its power to abrogate contracts to the Commission to be exercised only after a hearing and finding of unreasonableness under 206(a), a contract rate cannot be abrogated in any other manner. The language of Section 205(d), upon which petitioners place their entire reliance, that "No change shall be made by any public utility in any such [filed] rate * * * or contract * * * except after thirty days' notice to the Commission and to the public", clearly does not constitute an affirmative grant of authority to a public utility to abrogate its own contract unilaterally. The plain purpose of that provision is to prevent parties to rate contracts from changing rates by secret agreement without notice to the Commission and to the public.

A

It follows from the foregoing that the Court below was correct in amending its opinion so as to direct the Commission to dismiss the pending proceeding, which had been instituted under Section 205, without prejudice to the initiation of a new proceeding under Section 206(a).

In its opinion as originally published, the Court of Appeals remanded the case to the Commission with instructions "either to dismiss the proceeding or for further proceedings under Section 206(a)" (R. 483-484). The present respondent thereupon filed a motion asking the Court to amend its decision so as to provide that the pending proceedings be dismissed, "without prejudice to the initiation of a new proceeding under Section 206(a)" (R. 485). This motion was based on the proposition that, since the pending proceeding was commenced by the filing of a new schedule under Section 205, it was necessary first to dismiss that proceeding. Otherwise the contract might be found unreasonable nunc pro tunc as of the date of the commencement of the pending proceeding, which is what the Commission had stated it would do if such a finding were necessary. Such action would be contrary to the decision of the Court below on the merits that the contract was valid and binding until and unless found unreasonable by the Commission after a hearing under Section 206(a). The motion was granted and the opinion amended accordingly.

Petitioners now argue that it would be inequitable to dismiss the present proceeding because this would mean that even though the Commission in a new proceeding under 206(a) should find the existing rate unreasonable, it could only fix a *prospective* rate to be charged in the future. This would mean that the rates collected in violation of a legal and valid contract for a period of over two years would have to be returned to Sierra. In this

conclusion petitioners are, of course, quite correct. It would require a reversal of the entire basis of the lower court's decision to permit a rate previously filed under Section 205 to be retroactively validated by a subsequent finding that the contract was unreasonable.

The Solicitor General complains that this will subject PG&E to a "greater burden" (C. Br. p. 21).[8] PG&E goes so far as to assert that "*in equity and good conscience*" it "should be entitled to retain the increase since the unreasonableness will relate to the entire period during which the increase was collected" (Italics added) (P. Br. p. 37).[9] This is strange language for a company which has deliberately repudiated its solemn obligations. Surely "equity and good conscience" do not require that PG&E should be permitted to retain increased rates illegally collected in violation of a contract entered into after more than a year of negotiations, before any finding has been made that the public interest requires that the contract be abrogated.

Both petitioners are evidently laboring under the delusion that the power to abrogate contracts exists for the benefit of PG&E and that "equity and good conscience" requires that PG&E be promptly relieved of its contract obligations whenever it seeks such relief. They do not seem to realize that it is only the *public* interest, and not the interest of PG&E's stockholders, that gives rise to the power to abrogate contracts. And certainly the public interest will not be adversely affected by the fact that PG&E is compelled to live up to its contract until it has been set aside in accordance with law.[10]

8. Brief of Federal Power Commission in this case.

9. Brief of Pacific Gas and Electric Company in this case.

10. PG&E and the Commission also both complain that it would be an undue burden on the parties as well as on the Commission to compel the Commission to begin all over again with a new proceeding and the taking of new testimony, under 206(a). With this contention

B

PG&E's contention that there is no difference of substance between a proceeding under 205 and a proceeding under 206 is untenable.

The reason assigned by the Court below for its decision that a contract rate could not be changed in a proceeding under 205 was that the only issue in such a proceeding was the reasonableness of the proposed new rate, and that the reasonableness of the existing rate could only be passed on in a proceeding under Section 206(a). As expressly pointed out by the Court below, *both* rates might be reasonable, so that in a 205 proceeding an increase might be allowed even though the contract rate would have been found reasonable in a proceeding under 206(a). Thus, if a contract rate could be changed in a 205 proceeding, the contract might be abrogated even though it was perfectly reasonable.

PG&E asserts that "This is a surprising misunderstanding of the Commission's functions and duty in rate cases" (P. Br. 19).

According to PG&E there is no difference of substance between a proceeding under 205(e) and one under 206(a): "The end result, the just and reasonable rate, must be the same under either procedure" (P. Br. 17). The reason for this, says PG&E, is that:

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we are in sympathy. In making our motion to amend the opinion in the Court below we had assumed that in a new proceeding initiated by the Commission under 206(a) the Commission could act on the existing record, with such additional evidence as any party might desire to add. If there is any doubt as to this, we would have no objection to the order being further amended so as to provide that the case should be remanded to the Commission "with instructions to dismiss the proceeding under 205 without prejudice to the continuation of further proceedings under Section 206(a)" instead of expressly requiring the "initiation of a new proceeding under Section 206(a)", as it does now. But there can be no doubt that unless the 1948 rate contract is regarded as a complete nullity, the Section 205 proceeding must be dismissed before any further steps can be taken under Section 206(a).

> "If the Commission finds a rate to be reasonable a materially different rate is necessarily unreasonable" (P. Br. p. 8).

This they argue, is because the Commission's primary duty is not to review rates, but to *fix* "the reasonable rate":

> "Under either Section 205(e) or Section 206(a) the Commission does not sit to review rate fixing activities of others; it sits to exercise its power to determine the just and unreasonable rate" (P. Br. p. 23).

It is PG&E, and not the Court below, which by these assertions shows a "surprising misunderstanding of the Commission's functions and duty." To take the last contention first: It is plain from a mere reading of the two sections that the exact reverse is true: Under both sections the Commission in the first instance sits solely "to review rate fixing activities" of the Company, and not "to determine the just and reasonable rate." Under Section 205 it may review a change of rates proposed by a company. If it determines to hold a hearing as to the reasonableness of the new rate, it may after such hearing "make such orders with reference thereto as would be proper in a proceeding initiated after it had become effective."

The nature of the "orders" which "would be proper in a proceeding initiated after it [the rate] had become effective" is specified in Section 206(a):

> "Whenever the Commission, after a hearing * * * shall find that any rate * * * or contract affecting such rate * * * is unjust, unreasonable, unduly discriminatory or preferential, the Commission shall determine the just and reasonable rate * * * or

contract to be thereafter observed and in force, and shall fix the same by order."

Thus, it is apparent from the very terms of the Act that the Commission's primary duty under both sections is precisely what PG&E has said it was not: "to review the rate fixing activities of others". The Commission has no power to fix rates itself until it has found upon such review that the rates fixed by others are "unjust, unreasonable, unduly discriminatory or preferential."

In asserting that the Court below was in error in thinking that the proposed rate and the contract rate might both be reasonable, PG&E overlooks the obvious fact that the test of reasonableness to be applied by the Commission when reviewing an existing filed rate or a change in rates proposed by a company is quite different from that to be applied by a Court when reviewing a rate fixed by the Commission itself. It is, of course, well established that when the Commission imposes a rate upon a company to which the company has not agreed, that rate must be one which will produce a "fair return" on the company's investment. And, as PG&E correctly observes, this "*statutory* reasonableness is an area, rather than a pin-point * * * It is the Commission's duty * * * to pin-point the reasonable rate" within that area (P. Br. p. 19) and the Court's duty, on review, to fix the outer boundaries of the area. If the Commission fixes a rate within that area, it must be accepted by a court. If it fixes a rate which produces less than a "fair return," it will be set aside by the Court as confiscatory.

But that principle applies only when the Commission itself is fixing a rate because it has found the Company sponsored rate unreasonable. It is equally apparent from the language of the Act itself that where the Commission is reviewing an existing rate or change of rate proposed

by a company, it is not "pin-pointing" the reasonable rate. The "pin-pointing" has been done by the company itself. The Commission's duty in reviewing that rate is the same as that of a court sitting to review a rate fixed by the Commission. If the rate proposed by the company is within the area or "zone of reason" applicable to such a rate—*i.e.*, in the words of the Act, if it is not "unjust, unreasonable, unduly discriminatory or preferential"—the Commission has no more authority or power to reject the rate than would a court if the rate fixed by the Commission were within the zone within which the Commission may fix rates. Thus any rate proposed by a company which is neither exorbitant or unduly discriminatory or preferential must be approved by the Commission, and manifestly, several such rates might be selected by a company for its own legitimate business purposes, such as to meet competition and hold or attract business.

The correctness of this proposition is confirmed by the action taken by the Commission itself, as well as by the contentions advanced both by PG&E and by the Commission staff, in the proceedings here under review. The Court will recall that in the present case it was conceded that the proposed increase filed by PG&E would produce a rate of return of only 4.75% on PG&E's investment, whereas it was also conceded that a return of 5.5% would be a reasonable return on that investment for this type of business. Yet the Commission, having found that the proposed rate was neither "unduly discriminatory or preferential"—and of course it concededly was not exorbitant—had no alternative (absent the contract) but to find, as it did, that "the proposed rate is not unreasonable and is lawful" (R. 457, 466).

The principle involved was well stated by Commission staff counsel on the oral argument before the Commission:

> "I know of nothing in the cases so far as the law goes, and I know of nothing in policy, which says that this Commission should second-guess a company on differences in rates as long as both of them are reasonable and don't produce an unreasonable rate of return." (Official Stenographer's Report p. 1446, In The Matter of Pacific Gas and Electric Company Docket, No. E-6482. Page 1446 of the Record before the Court of Appeals)

Thus, it is apparent that the Court below was quite correct when it pointed out that the contract rate and the proposed new rate might both be reasonable—or, to be precise, that neither might be "unreasonable".

It is also apparent that a rate proposed by a company might not be "unreasonable" when reviewed by the Commission, while the identical rate might be found unreasonable by a court if imposed by the Commission. For example, if the Commission had sought to impose a rate producing a return to PG&E of only 4.75% on its investment, when PG&E was concededly entitled to a return of 5.5%, a court would have to reject such a rate as confiscatory at the suit of PG&E. Yet, if there were no contract in existence here and PG&E had proposed its increased rate, the Commission would have had no choice but to approve it, despite its 4.75% rate of return, because it was proposed by the company and was found by the Commission to be neither unduly discriminatory nor preferential.

Thus a rate which would be "unreasonable" if imposed by the Commission might be perfectly "reasonable" if proposed by the company. There is no substance to PG&E's elaborate effort to demonstrate that the Court below displayed "a surprising misunderstanding of the Commission's functions and duty in rate cases" (P. Br. p. 19). The shoe is on the other foot. The construction of the Act by the Court below was in all respects correct.

A new rate proposed by a utility under Section 205(d) may be perfectly reasonable, even though the existing contract rate may also be reasonable.

Hence, a contract rate can not legally be changed in a 205 proceeding, for in such a proceeding, it could be changed even though it were not unreasonable. It follows that the difference between a proceeding under Section 205(e) and one under 206(a) is one of substance, and that the dismissal of the pending proceeding commenced under the former section is a necessary prerequisite to any further proceedings which can be had under Section 206(a).

III

The fact that there has been a hearing in the present case does not help petitioners. The Commission did not make a finding that the contract was unreasonable, and even if it had, such a finding would not validate the Commission's order as a matter of law, and in any event would have to be rejected as unwarranted by the record.

Unlike *Mobile*, where the Commission denied Mobile's petition to reject United's filing and dismissed Mobile's proceeding, the Commission here, although it denied Sierra's petition to reject the filing, ordered a hearing under Section 205(e) into the reasonableness of PG&E's proposed higher rate and expressly reserved Sierra's right to maintain its contentions in that hearing.

At the close of the hearings the Commission found that PG&E's increased rate was not unreasonable and ordered that it become effective. That, of course, was not the finding that the contract rate was unreasonable which is required by the Act. Accordingly, the Commission's order was unlawful and the court below properly set it aside.

But petitioners point out that after rejecting Sierra's contention that the filing was illegal because it was in violation of the contract, the Commission continued:

> "However, we may point out that if a finding on the lawfulness of the 1948 contract rate were necessary or appropriate, on the record before us that finding would have to be that the 1948 rate is unreasonably low and therefore unlawful. For none of the evidence in this record warrants a finding that any rate would be reasonable that would produce a return of substantially less than the 4.75% resulting from the proposed rate, which is the minimum PG&E is willing to accept" (R. 464).

A

The Commission did not make a finding that the contract was "unreasonable."

PG&E argues earnestly that the above quoted statement constitutes, or at least should be construed by the Court as constituting, a formal finding of unreasonableness, if such a finding is required. We think the dissenting Commissioners were correct when, after quoting the foregoing language, they pointed out that "no such finding is made. Rather, it seems to have been carefully avoided" (R. 475). And this was the view taken by the Court below.

B

Even if the Commission's language could be construed as a finding of unreasonableness, it would not support the Commission's order.

PG&E further contends that this alleged "finding" supports the Commission's order, even though entered in a

205 proceeding, because there is no difference of substance between a proceeding under Section 205 and one under 206(a). As we have shown in the preceding point, that contention is untenable. For the reasons there set forth, even if the Commission had in fact made an affirmative finding of unreasonableness as required by Section 206(a) in its order entered on June 17, 1954, that order would still have to be set aside. The Commission can not by such a finding retroactively validate a rate increase filed under Section 205 which had been in effect since September of 1953, nine months before the finding was made. The right of the Commission to fix a new rate under Section 206(a) after a finding that the contract is unreasonable is prospective only. Until such a finding has been made, the contract rate is the only legal rate. As the Commission's order has the effect of validating the increase as of its effective date in September 1953, the order must be set aside and the filing rejected, before any proceedings can be undertaken under 206(a).

C

In any event, the Commission's purported "finding" is erroneous both as a matter of law and as a matter of fact.

Even if the Commission had made the finding which PG&E contends it made, that finding would have to be rejected by the Court because it would be directly contradicted by the evidence in the record. As just indicated, the only basis assigned by the Commission for such a finding is that the contract rate is "unreasonably low and therefore unlawful" and that it is "the minimum PG&E is willing to accept." The law is quite clear that the mere fact that a contract rate is low is not sufficient ground to set aside the contract and it is equally clear as a matter

of fact that when PG&E entered into the present contract, it expressed its willingness to accept the contract rate for fifteen years.

(1) *As a matter of law, a contract may not be set aside merely because it is unprofitable when, as here, it is not injurious to the public interest.*

The principle that a contract rate may not be set aside merely because it is unprofitable was enunciated by this Court in *Arkansas Natural Gas Co.* v. *Railroad Comm.*, 261 U. S. 379 (1923), at pp. 382-3, in the following language:

> "The question whether, in the absence of the statute—it being made to appear that the stipulated consideration was grossly inadequate—the commission, under the circumstances disclosed by the record, would have been under a duty to fix gate rates in contravention of the contracts, may be put aside with brief consideration. While a State may exercise its legislative power to regulate public utilities and fix rates, notwithstanding the effect may be to modify or abrogate private contracts (*Union Dry Goods Co.* v. *Georgia Public Service Corp.*, 248 U. S. 372, 375; *Producers Transportation Co.* v. *Railroad Comm.*, 251 U. S. 228, 232) there is, quite clearly, no principle which imposes an obligation to do so merely to relieve a contracting party from the burdens of an improvident undertaking. The power to fix rates, when exerted, is for the public welfare, to which private contracts must yield; but it is not an independent legislative function to vary or set aside such contracts, however unwise and unprofitable they may be. Indeed the exertion of legislative power solely to that end is precluded by the contract impairment clause of the Constitution. The power does not exist *per se*. It is the intervention of the public interest which justifies and at the same time conditions its exercise." (261 U. S. 379, 382-3)

This decision was closely followed by a very pertinent case in the Kansas Supreme Court: *Railroad & Light Co.* v. *Court of Industrial Relations*, 113 Kan. 217, 214 Pac. 797 (1923). In that case, the Kansas Commission, adopting the procedure prescribed by the U. S. Supreme Court in *Wichita Railroad* v. *Pub. Util. Comm.*, 260 U. S. 48 (1922), had held hearings as to the reasonableness of certain contract rates, and set them aside on the ground that they were unreasonably low. The Kansas Supreme Court reversed the Commission on the ground that the finding of unreasonableness was not supported by the evidence because there was no proof that the low rates were prejudicial to the public interest. In the course of its opinion the Court defined the circumstances under which a contract rate could be set aside as follows:

> "If, for instance, continued performance of the contracts in question should bear so heavily on the power company that its general revenues would be depleted to the extent that recoupment would have to be made at the expense of the other customers, or would otherwise be reflected adversely in its rates or service to that portion of the public served by the power company, the contracts could and should be abrogated under the police power; but if continued performance of the contracts would only affect the net profits or dividends on that portion of the power company's property devoted to performance of the contracts, then the public interest would not be affected, and there would be no occasion or excuse for the intrusion of the state's police power. (*Kaul* v. *Telephone Co.*, 95 Kan. 1, 147 Pac. 1130; *Re Rockingham County Light & P. Co.*, P.U.R. 1917 F, 24)" (113 Kan. 229, 214 Pac. 803).

In *Columbus R. Power & Light Company* v. *Columbus*, 249 U. S. 399 (1919), a street car company was under a clear contract obligation to furnish service at specified

fares. There was no evidence that the company could not carry out its contract obligations, nor even that it would not make some profit, however small, in doing so. This Court held that under these circumstances the company must abide by its contract: "But equity does not relieve from hard bargains simply because they are such" (249 U. S. 399, 414).

In applying these principles to the record in the case at bar, it becomes immediately apparent that the contract in question is not against the public interest.

In support of its determination that the rate producing a 4.75% return on this business is "not unreasonable and [therefore] lawful," the Commission points out that the company is willing to accept this low rate of return "Notwithstanding the stipulated fact that 5½% is generally a reasonable rate of return on the electric utility business of PG&E" (R. 464). The Commission continues:

> "It is apparent that PG&E regards the deficiency of .75 of a percentage point as warranted in order to attract and retain this particular business in the face of the alternatives that may have been available to Sierra. With the investment which PG&E has made and has undertaken to make in special facilities on which it would earn no return at all if it lost this particular business, it would require evidence of a kind not presented in this record to warrant a finding that the 4.75% rate of return it is willing to accept from this sale is unreasonably low. Not only is there no such evidence but it affirmatively appears that this deficiency is not offset by any excess return from other sales subject to our jurisdiction and that the California Commission has ruled that such deficiencies may not be offset by excesses from other PG&E sales which are subject to its regulatory jurisdiction. This, and the fact that no undue discrimination or preference results from the deficiency, as we have

already seen, makes clear that the proposed rate is not unreasonable and is lawful" (R. 466).

That these considerations are equally applicable to the contract rate is apparent from the following colloquy between a member of the Commission and Commission Staff counsel at the hearing preceding the issuance of the order:

> "Mr. Wahrenbrock: Well, if PG&E is willing to serve one customer at less than a fair return on that business and to earn only a fair return on all of its other customers, it seems to me that the other customers are not the victims of an undue discrimination because they're getting all that the law entitles them to in any event. They're paying only a reasonable return on the business to them.
>
> "Commissioner Smith: Isn't that the situation here?
>
> "Mr. Wahrenbrock: That seems to me to be the situation that will result from the new rate here, yes.
>
> "Commissioner Smith: It seems to be the situation that has existed all along, as I understand the record.
>
> "Mr. Wahrenbrock: That is right" (Official Stenographer's Report pp. 1447-1448, *In The Matter of Pacific Gas and Electric Company*, Docket No. E-6482. Pp. 1447-1448 of the Record before the Court of Appeals).

And again in his brief before the Commission, Commission Staff counsel said:

> "The only question would seem to be whether, in determining what is a fair return for this business, P.G.&E. should be held bound by the representations and agreement it made in 1948 as to a satisfactory return for the term of its agreement. Under the rate regulation practices heretofore followed by the California Commission and this Commission, no other customer of P.G.&E. will bear any greater

burden if P.G.&E. is held to its 1948 representations and the California Commission has held that it should be"[11] (Brief of Commission Staff pp. 33-34. In The Matter of Pacific Gas and Electric Company, Docket No. E-6482).

These statements seem to us to constitute a complete concession that the contract rate is not unreasonable.[12]

(2) *As a matter of fact the contract rate, and not the proposed new rate, is the "minimum PG&E is willing to accept."*

Absent the contract, the Commission is correct in basing its decision that a rate producing a return of only 4.75% was not unreasonable on the fact that PG&E is willing to accept the low rate of return. As we have shown above, the test of reasonableness of a rate proposed by a company is quite different from that applicable to a rate imposed by the Commission itself. The Commission could not have imposed a rate producing a return of substantially less than 5.5% without PG&E's consent. But with that consent, the lowest rate which the company is willing to accept must be approved by the Commission if it is not "unduly preferential or discriminatory."

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11. In view of these concessions, it is somewhat surprising to find in the Brief submitted herein on behalf of the Commission and subscribed by the author of the foregoing, the twice repeated statement that the effect of the decision below is "to allocate the burden of increased costs among PG&E's customers according to the existence of contracts and the order in which contracts expire." (C. Br., pp. 13, 36)

12. Commission Staff counsel sought to avoid this conclusion by arguing that if PG&E had entered into a large number of such contracts, its financial stability might be threatened. "The fact that only a very small percentage of its business is involved [in this contract] would not seem to alter the principle." This is not a question of "principle" but "fact." If this contract does not threaten PG&E's financial stability, as concededly it does not, it does not injuriously affect the public interest. If it did, or if PG&E had entered into so many that they would, they would all be set aside under 206(a), upon a finding that such were the facts.

But the Commission is in error in holding that the proposed new rate is "the minimum PG&E is willing to accept" (R. 464). The Commission ignores the fact that in 1948 PG&E solemnly expressed its willingness to accept the contract rate for a period of fifteen years. Thus the contract rate, and not the proposed new rate, is "the minimum PG&E is willing to accept." That is why that rate cannot now be disturbed.

Perhaps the simplest way of illustrating the error in the Commission's thinking on this subject is to point out that, on the very reasoning advanced by it in support of its approval of the 4.75% rate, if PG&E were now proposing to serve Sierra at the contract rate, which it is stipulated will produce a return of only 2.6% instead of 4.75%, the Commission would have to approve that rate. For, as we have seen, it is concededly neither preferential nor discriminatory and places no burden upon PG&E's other customers, and if proposed by PG&E (as it was in 1948, for a 15-year period) it would be "the minimum PG&E is willing to accept." It is the Commission's primary function to obtain for consumers the lowest reasonable non-discriminatory and non-preferential rate available. Whether a company offers to serve a customer at a rate producing a return of 4.75% or only 2.6% the rate which it proposes must be accepted by the Commission, provided it is neither discriminatory nor preferential. PG&E having agreed, for its own business reasons, to accept the lower rate for the duration of the contract, it remains the "lowest rate PG&E is willing to accept," and therefore the legal rate, unless and until it is found by the Commission that it has become "unduly discriminatory or preferential," or so burdensome that its performance

will prevent PG&E from performing its duties to the public.[13]

We submit, therefore, that it is indisputable on this record that if the Commission had made a finding that the contract was unreasonable because it was too low and was lower than PG&E was willing to accept, that finding would have to be set aside as against the law and the facts. The contract rate is just as reasonable as the new rate authorized by the Commission. This is the very situation referred to by the Court below: the contract rate and the proposed new rate are both reasonable.

IV

The existence of binding private rate contracts in no way interferes with the proper functioning of a rate regulatory agency.

Petitioners in both the present case and the *Mobile* case repeatedly assert that if rate contracts are held to be binding until and unless set aside by the Commission on a hearing and finding of unreasonableness, the Commission will be frustrated in the performance of its duties. We submit that the record in the present case presents a conclusive, practical refutation of such a contention.

As we have shown above (see pp. 4-9) PG&E has for many years entered into and observed binding contracts for the sale of power both under its P-30 rate sched-

13. It is, of course, not contended by any party hereto that the contract rate is so burdensome to PG&E that it will in any manner interfere with its ability to carry out its public utility functions. Indeed, the record shows that PG&E's management considers it more advantageous to serve a customer at even lower rates if necessary in order to meet competition. The Court will recall that in seeking general rate increases of its contract rates in 1952, PG&E expressly excluded its contract with the City of Redding, which is 10% lower than the rate in its contract with Sierra on the express ground that Redding, being located within a few miles of Shasta Dam, still enjoyed a strong bargaining position (R. 280-282).

ule approved by the California Commission in 1936 and under the P-31 schedule approved in 1945 and embodied in the present contract. At the time of the hearings before the Commission in 1950 and 1952 which we there discussed, there were at least twenty such contracts outstanding. These contracts have always been treated as binding by the California Commission, and until 1952 when PG&E thought it could safely repudiate them without losing the contract customers, they were also treated as binding by PG&E itself. It is also apparent that the California Commission found no difficulty whatever in performing its regulatory functions in such a manner as not to interfere with the continuing validity of these agreements.

In approving these contracts and insisting that they be observed, the Commission invariably saw to it that the burden of the contracts would fall solely on the company's stockholders and would not be passed on to PG&E's other customers. For example, the California Commission's Order of October 15, 1952 rejecting PG&E's attempt to increase its contract rates contained the following provision:

> "The revenues from these services will be computed at the new resale schedule for the purpose of determining applicant's over-all revenue requirements only, but the rates for such resale contract customers will not now be increased. By this method no burden will be placed on the other classes of customers but any burden will fall on the stockholders' portion of the earnings until such time as the contracts may have been renegotiated and have been authorized by the Commission." (R. 285)

Thus the public interest was at all times protected.

An example of how a company which believes that an existing contract has become so low as to justify its

being relieved from the burden of the contract may obtain such relief is presented in the case of *Railroad & Light Co. v. Court of Industrial Relations*, 113 Kan. 217, 214 Pac. 797 (1923). That case closely followed the decision of this Court in *Wichita Railroad & Light Co. v. Pub. Util. Comm.*, 260 U. S. 48 (1922). The Court will recall that that was the case in which this Court held that under the Kansas statute a contract rate could not be set aside by a mere filing of a schedule of new rates. The following year the Railroad & Light Company, in filing a new schedule requesting general increases, profited by that decision and excepted those rates embodied in contracts, but noted the existence of the contracts in its application. The Kansas Commission thereupon held hearings as to the reasonableness of these contracts on its own motion, found them unreasonable, and set them aside.[14]

In other words, it is quite apparent that rate contracts have been considered valid by State Commissions for many years and that they have never furnished any serious obstacle to a regulatory Commission's performance of its functions. Moreover, as indicated in our brief in *Mobile*, pp. 56-61, there is no evidence that the Federal Power Commission had ever permitted a contract rate to be increased by the mere unilateral filing of a new schedule prior to its action in this case and in the *Mobile* case. On the contrary, the records of the Commission indicate that at least as recently as 1948, the Commission itself recognized the existence and validity of rate contracts.[15] Thus,

14. This action was later reversed by the Kansas Supreme Court on the ground that the only evidence of "unreasonableness" was that the contracts provided a low rate of return, and that there was no evidence that the public interest was adversely affected by them. (See p. 42, *supra*.)

15. Since writing the brief in the *Mobile* case, our attention has been called to the case of *United Gas Pipe Line Co. v. Federal Power Commission*, 220 F. 2d 706 (5th Cir. 1955) S. Ct. Docket No. 302,

there is no merit to the contention of the petitioners that the existence of rate contracts is incompatible with the administration of the regulatory scheme set forth in the Federal Power Act.

V

Quite apart from the legal questions involved, it was an abuse of administrative discretion for the Commission to sanction PG&E's repudiation of its contract in the face of the undisputed evidence that it is not injurious to the public interest, and that the only effect of the repudiation is to benefit PG&E's stockholders. Moreover, the Commission's efforts to justify its action are arbitrary, capricious, unsupported by the evidence and contrary to the evidence.

As we have seen, the public interest is in no manner adversely affected by the contract here in issue. Concededly, any loss resulting from the low rate is borne ex-

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in which this Court denied United's petition for certiorari to the 5th Cir. on October 10, 1955. This case indicates that despite the position taken by them in the *Mobile* case, both United and the Federal Power Commission also still consider rate contracts to be valid and enforceable in the gas industry. In that case, United had entered into a contract with the approval of the Federal Power Commission to furnish gas to Mississippi River Fuel Corporation, the intervener, under a rather complicated rate schedule providing for two alternative rates depending upon the source of the gas. A dispute arose as to the proper construction of this contract. Mississippi contended that United had been overcharging it and brought a proceeding before the Commission to compel United to refund the overcharges. United contended that under its construction of the contract its charges were correct. The Commission construed the contract in favor of Mississippi and ordered United to refund over $2,000,000 to Mississippi. On review the Court of Appeals, holding that the only issue in the case was the construction of the contract, sustained the construction placed upon it by the Commission. Thus it is apparent that even at the present time both the Commission and United believe that under some circumstances rate contracts are as valid, binding and enforceable in accordance with their terms as any other contract. Why they take the opposite view in this and the *Mobile* cases, we are at a loss to understand.

clusively by PG&E's stockholders. Moreover, the ultimate beneficiaries of the low rate provided for in the contract are the consumers in the State of Nevada. It has always been our understanding that the primary function of the Commission was to obtain the lowest available rates for the consumers. Certainly it was not created in order to protect a utility company's stockholders from the burdens of an unprofitable contract, just because the threat of competition which made the contract advantageous when it was entered into has ceased to exist.

It is too plain from the record to permit serious dispute that PG&E's management entered into this contract in 1948 after many months of negotiation, during which it sought to compel Sierra to accept a contract at substantially higher rates with an "escalator clause", thus permitting further automatic rate increases depending on increased cost of fuel. It was only after Sierra had flatly rejected such a proposal and when PG&E itself had been approached by the Bureau of Reclamation with a suggestion that it wheel Shasta power to Nevada for the Bureau's account, that PG&E's management finally acceded to Sierra's insistence upon a lower rate and offered the contract here in issue. (See *supra*, pp. 5-7). Moreover, it is also perfectly plain that it is only because the threat of competition from the Bureau of Reclamation no longer exists that PG&E is now attempting to repudiate that contract. This is apparent from PG&E's own testimony before the California Commission during the course of the 1952 hearings that it wished to increase all of its contract rates with the exception of its contract with the City of Redding where competitive conditions still exist (R. 281). Thus it is apparent that if the threat of Government power which induced PG&E's management to offer this contract in 1948 still existed, PG&E would undoubtedly be perfectly willing to carry out its contract.

We submit that the total lack of elementary business morality shown by PG&E in cynically repudiating its contract after that threat has been removed—and removed, as the record shows, by the action of PG&E itself in entering into contracts tying up all of the Bureau's available power[16]—should not be sanctioned by the Federal Power Commission. That is not the purpose for which it was created, and we suggest that it is a violation of its functions and an abuse of the administrative discretion vested in it by Congress to have done so. We submit that the majority should have concurred with the dissenting Commissioners when they said; "* * * PG&E * * * having made its bed, should be required to lie in it,—absent some showing of harm to the public interest if this axiom were followed" (R. 473).

Moreover, that the Commission itself recognized that some justification of its action was necessary in addition to its erroneous contention that as a matter of law the contract could be abrogated unilaterally under Section 205, is evident from the lengths to which the Commission has gone in its opinion in attempting to justify its action. An examination of these attempts at justification will show that they are arbitrary, capricious, unsupported by the evidence and contrary to the evidence.

Primarily the Commission advances three contentions,[17] in justification of its order:

> (a) "Second, we find Sierra's argument that it has foregone other sources of supply in reliance upon the continuance of all terms of the 1948 agreement unconvincing in the light of the record which clearly shows that in 1948 Sierra regarded the

16. See footnote 6 at p. 9, *supra*.

17. The Commission also relies on the legal question as to the validity of the contract, fully discussed heretofore, and includes an irrelevant assertion that the Commission is not bound by the decisions of the California Commission.

other sources of supply as being so unacceptable that PG&E became, in fact, the only feasible source.

(b) "Third, we also find unconvincing Sierra's argument that it would be grossly unfair to change the rate set forth in the 1948 contract while leaving all other terms unaltered, in view of the fact that Sierra has not shown, and on cross examination its president could not suggest any alterations which he thought should be made in other terms if the rate were changed as proposed.

* * *

(c) "Fifth, even if PG&E's entry into the 1948 contract were to be accepted as demonstrating that the then foreseeable rate of return under that contract must be deemed the rate of return which is still reasonable for this particular business, it appears from the record here that due to the increases in other costs which have occurred since then the presently proposed increase will merely restore that rate of return, not go above it." (R. 451-452)

Upon examination of the record it will be seen that none of these attempted explanations will bear analysis in the face of the undisputed facts disclosed by the record. On the contrary, it is plain from the record that they are arbitrary, capricious, unsupported by the evidence, and contrary to the evidence.

A

It is clear from the testimony of PG&E's own officials and from documents produced from its own records that the threat of Bureau competition was the motivating factor in inducing PG&E to enter into the 1948 contract.

The Commission in its opinion justifies its approval of the proposed new rate, despite the low return, on the ground that

"It is apparent that PG&E regards the deficiency of .75 of a percentage point as warranted *in order*

> *to attract and retain this particular business in the face of the alternatives that may have been available to Sierra.*" (Italics added.) (R. 465)

Nevertheless, the Commission also asserts that it finds Sierra's arguments that it has foregone other sources of supply in reliance upon the 1948 agreement unconvincing because "Sierra regarded the other sources of supply as being so unacceptable that PG&E became, in fact, the only feasible source" (R. 451). Of course, as a matter of law it is immaterial whether Sierra drove a harder bargain than its bargaining position truly justified. A contract can hardly be set aside either in law or in equity because one of the parties got the better of the bargain. But we think the record so clearly establishes the exact reverse that it is apparent that the Commission's finding in this regard is so arbitrary as to be little less than capricious.

The Court will recall that at the hearings before the California Commission held in 1950, PG&E expressly requested the Commission to exempt twenty of its contract customers from a proposed rate increase, explaining that the contracts had been entered into to meet competition and that it would be "double dealing repudiation" to seek an increase. Sierra had not been included in the original list, but in the course of the hearings Mr. J. S. Moulton, vice president and executive engineer of PG&E, asked that Sierra be added to the list in the following language:

> "* * * There is one other similar contract which should be added to Exhibit K [the exhibit listing the customers to be exempted from the rate increase], in my opinion. That is a 15-year contract made with the Sierra-Pacific Power Company dated March 4, 1948, which was approved by this Commission in Decision No. 41,537 dated April 27, 1948.

> That contract was negotiated under conditions much the same as those which existed in the case of the Redding contract, and these other contracts which I have described". (R. 271)

The Redding contract to which Mr. Moulton referred provided for a rate of 10% lower even than the straight P-31 rate. This low rate had been approved because it was shown that the City of Redding was within ten miles of the Shasta Dam so that its bargaining position was particularly strong (R. 278).

Furthermore, in answer to a question on cross examination as to why the contract with Sierra Pacific Power Company should also be exempted from the proposed increase, Mr. Moulton replied:

> "* * * That goes largely to the fact that the contract along with the contracts such as with the City of Redding, which you heard something of this morning, were obtained under competitive conditions with those groups in Nevada which were actively interested in trying to get the Bureau of Reclamation to give service to the Sierra Pacific area in Nevada from the Central Valley Project in California. We finally made a 15-year contract with Sierra Pacific. We made a longer contract because we understood [sic] to build an additional line to supply them and we felt we needed that protection of a long contract. I am very sure that those competitive conditions existed then and that there is still agitation among certain groups in Nevada to get a line * * *." (R. 273)

As indicated above (pp. 9-10), in 1952, after the danger of the competition which had induced PG&E to enter into these low rate contracts had been removed, PG&E attempted to repudiate all of them except its contract with the City of Redding, which still occupied a favorable competitive position. In refusing to permit such "double dealing repudiation", the California Commission said:

> "In connection with these special contracts, we point out that the applicant, in order to forestall alleged government competition, requested authority from this Commission to enter into said contracts with the clear understanding that its stockholders must bear any burden which the applicant might sustain as a result of the operation of any such contracts. Therefore, equity calls for the treatment which we have accorded to these special contracts." (R. 285-286)

[6] Moreover, that in the final negotiations resulting in the offer of the contract embodying the P-31 rate, PG&E's management was concerned solely with the problem of meeting competition is incontrovertibly established by documentary evidence produced from PG&E's own files. We have seen that on January 22, 1947, PG&E offered Sierra a new 15-year contract which was wholly unacceptable to Sierra, and that throughout the spring and summer of that year Sierra carried on intensive negotiations with the Bureau of Reclamation looking to the possibility of bringing low cost government power to the consumers of Nevada. On August 15, 1947, these negotiations had progressed to such a point that the Bureau of Reclamation wrote PG&E to inquire about the possibility of having PG&E transport Bureau power from Shasta Dam to Nevada over its own transmission facilities for delivery to Nevada (Sierra) at the Summit (R. 415-416). The record shows, in the form of extracts of the minutes taken at meetings of the Advisory Committee to PG&E's President, that PG&E thereupon made great efforts to compel Sierra to accept the contract proposal of January 22nd (R. 338-341). These efforts culminated in the conference with Sierra's President on October 4th at which the January 22nd contract offer was flatly rejected (R. 339-341). Immediately after Sierra's refusal to accept this proposal to continue with PG&E at the existing high rate,

PG&E's President directed that a study be made of the applicability to Sierra's business of PG&E's P-31 rate (R. 340-341).

In evidence as Exhibits 44 (R. 416-424) and 45 (R. 424) are the studies which were made by PG&E in response to the direction of its President to consider the application to Sierra of the P-31 rate.

Owing to the failure of PG&E to produce these exhibits (which were only discovered accidentally by Sierra at the very close of the second hearings (R. 114-118)) and call the officials who had prepared them as witnesses, it is necessary to scrutinize them rather closely in order to understand their true significance.[18] But we think it is quite apparent from an examination of Exhibit 45, which consists of pencil notations made by Mr. Sutherland, Vice-President in Charge of Sales of PG&E, on October 11, two weeks before the contract was finally offered to Sierra, that he was concerned entirely with the problem of meeting the threatened competition from the Bureau, and particularly that he was anxious to meet the Bureau's proposal that PG&E should transport or wheel Bureau power for the Bureau's account to the Summit (R. 424). On the second sheet of Exhibit 45, he says that if PG&E agreed to do this, "* * * we would be under pressure to do the same for others" (R. 424).

On Exhibit 45, Mr. Sutherland computed the costs to Sierra of purchasing power at the Summit under the

18. PG&E's witness in support of Exhibits 35 (Revised), 36 (Revised), 39, 40, 41 and 42, frankly admitted he had never seen Exhibits 44 and 45 before. However, when confronted with them he dutifully attempted to discredit them as "hastily prepared" and a "hodge-podge"; notwithstanding the fact that they had been prepared at the direction of PG&E's President by the Vice-president in charge of Sales and the witness' own chief, PG&E's Chief Rate Engineer. (Official Stenographer's Report, *In the Matter of Pacific Gas and Electric Company*, Docket No. E-6482, pp. 1318-1332, 1333-1337, 1326 of the Record before the Court of Appeals.)

exchange or wheeling agreement at the Bureau's advertised resale rate plus PG&E's transmission costs, and compared the results with Sierra's costs if it purchased the power from PG&E under the P-31 rate. These computations show, as Mr. Sutherland puts it, that "there is little to gain. (—2 to 4%)" (R. 424). Later on, he concludes "It is a toss-up between P-31 and CV [Central Valley or Bureau rate] + costs to Summit. The exchange basis plus charges is no better than P-31" (R. 424).

Thus it is apparent that PG&E's management was concerned solely with the problem of meeting the two proposals for supplying Sierra being advanced by the Bureau of Reclamation.

The Commission's contention that, despite this incontrovertible evidence taken from PG&E's own files and the testimony of its own officials, the record discloses that PG&E was really the only source of additional power available to Sierra is based upon the testimony of Sierra's witnesses before the California Commission in 1948 at the hearing at which the approval of the contract was under consideration. As the record of that hearing shows (R. 198-259), approval of the contract was being vigorously opposed by numerous representatives of consumer interests in the State of Nevada, who were insisting that further time should be given them to study the situation and determine whether or not the proposed contract was really better than the Bureau's offer to furnish Sierra with cheaper power from Shasta Dam (R. 254-255). Indeed, at the close of the hearings, the Commission granted these objectants additional time in which to determine whether they had any evidence to present in support of their contentions (R. 257-258).

In opposition to these contentions Sierra's management, having entered into the contract, naturally emphasized the reason which had impelled them, after due deliberation

and a comparison between PG&E's offer and the pending offer from the Bureau, to accept PG&E's offer of the P-31 rate, even though its costs would average .5 mills higher than the cost under the Bureau's proposal; namely, the probable inability of the Bureau to construct the new lines in time to meet the anticipated forthcoming peak demands.

But even so, the testimony relied on by petitioners does not support their contention. On the contrary, the testimony of Sierra's rate-engineer is merely that the anticipated delay in constructing the line "* * * meant that if we should take power from the Bureau and that if our load continued to increase at the present rate we would not be able to take on additional loads during 1950 or 1951 until the Bureau line was placed into operation" (R. 221-222). And again, "After taking all of these points into consideration I recommended to Mr. Tracy [President of Sierra] that, in my opinion, the Pacific Gas and Electric Company was the best [not the only available] source of supply at the present time, that the Reclamation Bureau contract was premature" (R. 223).

Respondents also place reliance upon various memoranda prepared by Sierra's management in which emphasis is laid on the undesirable features of the Bureau's proposals (R. 345-355). We think it is obvious that, having determined to accept PG&E's offer and to reject the Bureau's, Sierra's management was preparing to meet the criticisms which it knew would be leveled against it by the Nevada interests. Just as PG&E's vice-president, Moulton, advised his management in February 1948, that if the proposed contract were attacked because of the low rate it could be justified only on an incremental cost basis (R. 426-427), so Sierra's management knew that it could only satisfy the objections of Nevada consumers and their representatives by emphasizing the undesirable features of

the Bureau's proposals. Certainly this evidence does not prove that PG&E was the "only feasible source of power."

It seems to us that a consideration of this evidence conclusively demonstrates that if PG&E had not offered to reduce the existing rate to the substantially lower P-31 rate, Sierra would have been forced by public opinion, the demands of its consumers, and in all probability by the Public Service Commission of the State of Nevada (all of which interests were represented at the hearing), to accept the Bureau's pending proposals or find another source of power. They would never have been permitted to accept PG&E's original offer of a new 15 year contract at existing rates, for the obvious reason that the very material saving in costs under the Bureau's proposal would outweigh whatever inconvenience might result during the peak periods from the delay in constructing the transmission lines.

B

The only reason Sierra can not point to any provisions of the contract from which it should be relieved if the rate is increased is that its alternative sources of power no longer exist.

In a further effort to justify its refusal to abandon cost of service as the test of the reasonableness of PG&E's increased rate, the Commission states:

> "Third, we also find unconvincing Sierra's argument that it would be grossly unfair to change the rate set forth in the 1948 contract while leaving all other terms unaltered, in view of the fact that Sierra has not shown, and on cross examination its president could not suggest any alterations which he thought should be made in other terms if the rate were changed as proposed." (R. 451)

The short answer to this statement, of course, is that Sierra's position has so changed since the 1947 negotia-

tions leading to the contract with PG&E that it serves no purpose now for Sierra to be relieved from other provisions of that contract. It is a matter of common knowledge that the cost of building steam plants has increased so much since 1948 that that source of power is no longer available (R. 19-20), and as we have seen, PG&E itself has successfully removed the possibility of Sierra obtaining Shasta power directly from the Bureau by contracting to purchase all of Shasta's available power for its own use (R. 17-18, 57-58, 58-61).

Having relied on PG&E's good faith when it entered into the contract (and which PG&E reaffirmed before the California Commission in 1950 (R. 268-271, 277-278), Sierra is now in a position where if PG&E is permitted to repudiate its contract, there is no relief which Sierra can obtain by having the Commission rewrite other provisions of that agreement. Its only apparent relief will be to seek increases in its local rates from the Public Service Commission of Nevada, and thus pass its losses from the Commission's action on to its consumers.

C

The Commission's attempt to justify its decision on the ground that the rate of return under the new rate is no higher than the rate anticipated under the contract is not only immaterial, but is wholly unsupported by the record, and, indeed, is directly contradicted by the record.

The Commission seeks also to justify its decision upholding PG&E's increased rate upon the ground that it will provide PG&E with no more than the rate of return which was reasonably foreseeable to it at the time it negotiated the 1948 contract with Sierra (R. 464-465, 453).

This contention is admittedly based upon the mere inference that in late 1947 PG&E's management, using cost of

service studies made in 1946, estimated the rates of return which it could expect to receive from a contract with Sierra before offering Sierra, on October 25, the P-31 rate upon which the contract was finally negotiated (R. 453-454). The Commission bases its "inference" upon PG&E's Exhibit 35 (Revised), which purports to develop this "reasonably foreseeable rate of return", but is conceded to be purely a hypothetical reconstruction of something that never happened—a present guess of what PG&E's management *would have computed had they in 1947, made such a study* (R. 356-408, 453).

The short answer to the Commission's reliance on this "exhibit" is that the affirmative evidence in the record—not mere inference—*shows those considerations which actually did motivate* PG&E in its contract negotiations with Sierra and *those studies which PG&E actually did make* in advance of offering the 1948 contract terms to Sierra, and that evidence conclusively shows that those considerations bore no relation whatever to the "reasonably foreseeable" rate of return relied on by the Commission.

As we have just seen, Exhibits 44 (R. 416-424) and 45 (R. 424) are the studies which were made by PG&E in October of 1948, in response to the direction of its President to consider the application to Sierra of the P-31 rate. Exhibit 44 was prepared by the same Mr. B. B. Beckett, PG&E's rate engineer, who, as we have seen above (pp. 25, 26), was PG&E's witness in support of the P-31 schedule before the California Commission in 1945. The Court will recall that Mr. Beckett's basic thesis was that the P-31 rate was profitable to PG&E if computed on an "incremental basis", even though it would not be, if computed on the customary "allocated cost of service basis" (p. 26, *supra*).

The Commission majority seeks to dismiss these exhibits by asserting that "[t]hey were not computations of

PG&E's costs of service under the P-31 rate * * *" (R. 454). But Sheet 1 of Exhibit 44, under the legend "Cost to P.G.&E. Co." shows exactly what the cost of serving Sierra under the P-31 rate would be and what elements would be involved in that cost (R. 49). It shows also the revenue both for the year 1947 actual and for the years 1952 and 1960 estimated—and that the revenues "On P-31 plus $30,000/Year" (for standby) would substantially exceed the costs (R. 418).

The method used in determining the cost to PG&E is described in detail on Sheet 3 of Exhibit 44, which begins as follows:

> *"Cost to P.G.&E.*
>
> The method used in computing the cost to P.G.&E. of power delivered to Sierra at Summit, assuming this power to be purchased at Shasta Substation under our present Shasta contract, is the same as that developed for our study of 7/16/47 on the Denison Dam contract provisions applied to our system. * * *" (R. 421)

This sheet then lists and explains the items included in arriving at these costs, which are computed on an "incremental-cost basis" (R. 474), and not on the basis of any such study as that set forth in Exhibit 35 (Revised). They are made up of PG&E's cost of purchasing the power from the Bureau at Shasta Dam and the cost of transporting the power to the Summit, which include "* * * 6% for return and 2.2% for income taxes on historical cost" (R. 421). As we have just pointed out, PG&E always computed its estimated costs and estimated return under its P-31 contracts solely on an "incremental basis".

Mr. Beckett's study also compared the results under the P-31 proposal with existing rates and with the Bu-

reau's alternative proposal to build its own lines over the mountains and transport power directly into Nevada, where it would be resold to Sierra at the Bureau's resale or "postage stamp" rate R. 416-424). As appears on the face of the memorandum transmitting that study, it was to be taken to Reno in connection with the forthcoming meeting on October 24. It was at that meeting that Sierra was first offered the P-31 rate which it ultimately accepted.

Thus, the conclusion is inescapable that PG&E offered the P-31 rate on the theory that it could be justified if costs were allocated on an incremental basis (R. 426-427), as pointed out by the dissenting Commissioners (R. 472-474), and that the use of this method of allocating costs was dictated by the need of meeting the threatened competition from the Bureau and holding Sierra's business. As we have seen, that is just what the P-31 rate was designed for.

We submit that the existence of Exhibits 44 and 45 conclusively shows that Exhibit 35 (Revised) is of no probative value whatever in these proceedings under any theory, that it should never have been offered in evidence by PG&E, and should never have been accepted as evidence by the Commission. We can see no possible basis for accepting a concededly hypothetical reconstruction of a study that was never made in order to show what PG&E's management might have been thinking about when they entered into this contract, when Exhibits 44 and 45 clearly show that at that very time they were in fact thinking about something quite different.

We submit that this record overwhelmingly sustains the position of Commissioners Doty and Smith that "• • • Sierra's request to file its proposed supplemental requests for findings of fact and conclusions of law [relating to Exhibits 44 and 45] should not be brushed aside lightly

as 'unnecessary or unwarranted'" (R. 474-475). 'Certainly they cannot be brushed aside on the ground that "[t]hey were not computations of PG&E's costs of service under the P-31 rate * * *" (R. 453-454).

Thus the Commission's attempted explanations of its action in permitting PG&E to increase its rates in violation of its contract are arbitrary, capricious, unsupported by the evidence, and contrary to the affirmative evidence in the record. The record contains no reasonable or justifiable explanation of the Commission's action. The contract rate is "the lowest rate available" to Sierra and its customers. Enforcement of the contract in accordance with its terms will cause no injury to anyone except the stockholders of PG&E. Those stockholders got the benefit of the contract when Sierra gave up all opportunity of obtaining cheap Government power from the Bureau. Having obtained that benefit, there is no possible public interest requiring that they be relieved of the burden of paying the agreed price for that benefit. The order below should be set aside as an abuse of administrative discretion, quite apart from the legal question as to the validity of the contract.

CONCLUSION

For the foregoing reasons, it is respectfully submitted that the judgment below should be affirmed.

Respectfully submitted,

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